

4. Study the extract below and answer the questions that follow.

Tariff cuts in Vietnam

- ❶ The Vietnamese economy began to feel the impact of entry to the World Trade Organization (WTO) in January. Under its WTO commitments, Vietnam has begun to cut tariffs on more than 1800 imported items. The cut is quite large for some commodities, such as fabrics, where the **tariff** has dropped from 40 % to 12 %.
- ❷ Taking advantage of the lower tariffs, businesses have imported a large quantity of foreign goods, and the prices of goods at the retail stores have fallen as the tariff cuts have been passed on to consumers. In particular, the price of imported motorbikes has been reduced significantly. For example, the price of a Honda motorbike has gone down from US\$2200 to US\$1600. The tariff cuts expand consumer choice, with more goods available, and provide increased competition between local and foreign goods. Also it is hoped that the tariff cuts will reduce costs for businesses, putting downward pressure on inflation.
- ❸ The government has estimated that the loss of revenue due to tariff cuts will be US\$63 million per year for the first 5 years, equivalent to 7 % of the total revenue from import tariffs. In order to offset the revenue loss, the government hopes to collect more revenue from a growing economy. WTO membership will create opportunities for Vietnam to attract **foreign direct investment**, expand markets, develop business and increase exports.
- ❹ Economists think that as Vietnam opens its market under WTO rules, prices should fall further. For example, allowing more foreign producers into Vietnam will increase the supply of goods and services. Economists also believe that less protection will lead to a more efficient allocation of resources. It is expected that all the changes will help create a more competitive market.

[Source: adapted from *Saigon Times Weekly*, 14 April 2007]

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(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) tariff (*paragraph ①*) *[2 marks]*
 - (ii) foreign direct investment (*paragraph ③*). *[2 marks]*
- (b) “The price of a Honda motorbike has gone down from US\$2200 to US\$1600” (*paragraph ②*). Using an appropriate diagram, explain the impact on the quantity demanded of Honda motorbikes of a decrease in price of Honda motorbikes. *[4 marks]*
- (c) Using a tariff diagram, explain how tariff cuts could put “downward pressure on inflation” (*paragraph ②*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the impact of the lower tariffs in Vietnam on domestic producers, consumers and the government. *[8 marks]*